

## Other Views

# Pensions a likely train wreck for S.J.

**By Daniel Borenstein**

Recent San Jose actuarial reports show \$3.5 billion of city debt for underfunded pension and retiree health benefits — a shortfall that works out to about \$11,000 for every household in the city.

Yet, as Mayor Chuck Reed proposes substantive pension reform, workers and a local television reporter are hyperventilating about irrelevant numbers that distract from the ballooning debt.

If not for major layoffs and salary cuts last year, the shortfall would be much worse. It would also be much larger if the city used more realistic investment earnings assumptions rather than relying on overly optimistic forecasts.

Nevertheless, the calculations show the city's retirement programs combined have only 56 percent of the funds they should. Put another way, the unfunded liability equals about eight years of city payroll.

To understand what's going on here, keep in mind that employees earn additional future retirement benefits for each year that they work along with their salaries. So the city and its workers should invest enough money annually to cover the future costs of those newly earned benefits.

The city has three problems: First, the amount that should be set aside for those newly earned benefits has increased.

Second, even that greater amount isn't enough because the payment calculation relies on those optimistic investment assumptions.

Third, past reliance on unrealistic assumptions, retroactive benefit increases and actuarial changes have caught up with the city, leaving it with huge unfunded liabilities for pensions. As for retiree health benefits, only small amounts have been set aside for future benefits.

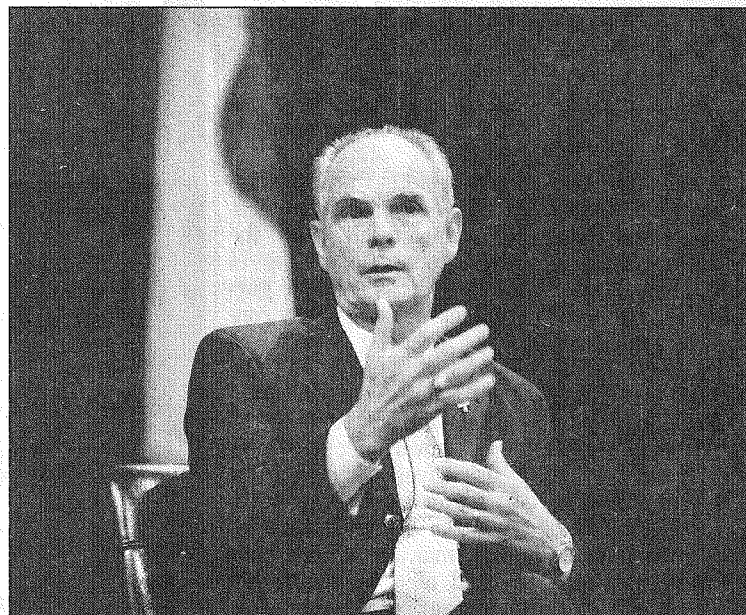
The resulting debts are treated like mortgages, with annual payments spread over as much as 30 years, thereby passing costs to the next generation. The city must pay off the entire pension shortfall; workers have no obligation.

For retiree health, workers make a small contribution toward the debt.

The benefits driving this are:

■ **Retiree health care.** The city provides free lifetime insurance to workers who retire from San Jose after 15 or more years of service. Spouses and dependents are also covered. The plans are only 9 percent funded with a \$1.9 billion shortfall.

■ **Pensions.** The plans are 74 percent funded with a \$1.6 billion shortfall. Pension benefits are based on age at retirement, top annual salary and years on the job. Retired firefighters and police who worked 26 to 30 years are collecting an average \$92,900 a year. Retirees from other departments



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San Jose Mayor Chuck Reed's proposals for pension reform have been met with anger by local unions. According to reports, each household owes \$11,000 to cover the underfunded pension debt.

with the same experience average \$60,432 a year.

While city workers contribute to the pension and retiree health care plans through payroll deductions of about 12 to 19 percent of their salaries, a much larger burden falls on the city.

For police and fire, the city expects to pay 66 cents additional cost for every dollar of payroll in the upcoming 2012-13 fiscal year.

For other workers, the city will pay 52 cents. That works out to a total of about \$251 million for the year, a figure expected to rise to \$320 million by 2015-16.

Before the staff reductions and pay cuts implemented last year, the city was looking at a tab of about \$400 million for 2015-16. The union and NBC Bay Area furor focuses on past comments by the mayor and retirement system director

that the number might be larger than \$400 million. In fact, it probably should have been much more, a point the unions and the reporter ignore.

The retirement system forecasts hinge on investment assumptions of 7.5 percent annual returns, which they have a less than a fifty-fifty chance of meeting. Using more realistic assumptions, the original \$400 million forecast and the current \$319 million projection would increase significantly.

Moreover, the unions and NBC miss the bigger point: These amounts include only a small payment toward the unfunded liability, a debt for work that has already been completed.

For pensions, the city is making the minimum payment on its mortgage, leaving most of the balance for future generations. For retiree health, it's worse: Only part of the minimum payment is being covered.

This is a potential train wreck left for future generations to clean up. The mayor deserves credit for trying to avert a disaster.

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